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# Message Text

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21
ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 FS-01 OPR-02 IGA-02 SAM-01 PA-01 PRS-01 /088 W
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FM AMEMBASSY MADRID
TO SECSTATE WASHDC 4714
INFO US MISSION TO OECD PARIS 1345

C O N F I D E N T I A L MADRID 1409

E.O.11652: GDS
TAGS: EFIN, ECON, SP
SUBJECT: COMMENTS ON GOS DEVALUATION

REF: MADRID 0986

1. SUMMARY. THE GOS DECISION TO DEVALUE THE PESETA BY 10 PERCENT FEB 9 HAS ELICTED CONSIDERABLE CRITICISM IN BANKING AND ECONOMIC CIRCLES, LARGELY ON GROUNDS THAT ITS INFLATIONARY EFFECTS WILL MORE THAN LIKELY OUTWEIGH ANY BALANCE OF PAYMENTS BENEFITS ACCOMPANYING PRICE STABILIZATION MEASURES, IS MEANINGLESS. HOWEVER A NEW GOS ECONOMIC PROGRAMN WHICH SHOUL BE ANNOUNCED AT CABINTET MEETING TODAY, IS EXPECTED TO INCLUDE MEASURES TYPICALLY ASSOCIATED WITH DEVALUATION AND SHOULD QUIET SOME, BUT BY NO MEANS ALL, OF THE PRESENT CRITICISM. AT SAME TIME THERE ARE SOME WHO FEEL PESETA REMAINS OVERVALUED AND THAT FURTHER DEVALUATION, ORDER OF 5 PER CENT, MAY BE NEEDED BEFORE END OF 1976. END SUMMARY.

2. DECISION TO DEVALUE APPEARS TO HAVE BEEN LARGELY OR ENTIRELY THAT OF MINISTER OF FINANCE VILLAR MIR. BANK OF SPAIN REPORTEDLY WAS NOT INVOLVED IN FINAL DIS-
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CUSSIONS AND WAS ONLY INFORMED AFTER DECISION HAD BEEN MADE. THIS HAS BEEN TYPICAL OF VILLAR MIRS FREEWHELING

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METHODS SINCE HE BECAME MINISTER AND HAS
PROMPTED CONSIDERABLE CIRTICISM, NOT ONLY FROM THE
ECONOMIC COMMUNITY WHICH VIEWS HIM AS AN UNKNOWLEDGEABLE
OUTSIDER, BUT FROM SOME OF HIS OWN STAFF WHO FIND
HIM DIFFICULT TO WORK FOR AND NOT PARTICULARLY WILLING
TO LISTEN TO ADVICE.

3. WHILE CRITICISM OVER DEVALUATION IS INSPIRED PARTLY
BY POLITICAL CONSIDERATIONS AND PARTLY BY A CERTAIN DIS-
DAIN FOR VILLAR MIR BY SPANISH ECONOMISTS, THERE ARE
NEVERTHELESS SOME VALID ECONOMIC QUESTIONS AS TO WHETHER
THE MOVE WILL ULTIMATELY BE BENEFICIAL. THE THREAT OF
RENEWED INFLATION REMAINS A MAJOR PROBLEM FOR THE SPANISH
ECONOMY. GOS WILL HAVE TO COME UP WITH MEASURES TO
COUNTER INFLATIONARY ASPECTS OF DEVALUATION IF POTENTIAL
BENEFITS OF NEW EXCHANGE RATE ARE NOT TO BE LOST IN
RENEWED WAVE OF WAGE AND PRICE INCREASES FOLLOWED
ULTIMATELY BY THE NECESSITY FOR A FURTHER DEVALUATION,
WITH INCREASIG MILITANCY FROM LABOR, WAGE SETTLEMENTS
THIS YEAR OF 25 TO 30 PERCENT ARE LIKELY TO BE COMMON-
PLACE; PREVIOUS GOS EFFORTS TO CONTROL WAGES AND PRICES
HAVE BEEN NOTABLY UNSUCCESSFUL AND THERE IS UNDERSTAND
ABLE DOUBT THAT ANY NEW GOVERNMENT MEASURES CAN IMPROVE
MUCH ON PREVIOUS PERFORMANCE, PARTICULARLY WHEN GROWING
UNEMPLOYMENT IS FORCING GOS INTO A MORE EXPANSIVE FISCAL
POLICY THAN IT MIGHT OTHERWISE BE FOLLOWING. SOME ARGUE
THAT TO BE SUCESSFUL A LARGER DEVALUATION WAS NEEDED OT
THAT A STILL FURTHER DEVALUATION WILL BE NECESSARY TO
ENSURE EXPANDED EXPORT EARNINGS, INCREASED INVESTMENT,
AND A REDUCTION IN UNEMPLOYMENT. IN ANY CASE A KEY TO
WHETHER THE DEVALUATION WILL WORK WILL BE PRICE CHANGES OVER
THE NEXT SIX TO TWELVE MONTHS.
OFFICIAL ESTIMATES THAT THE DEVALUATION WILL CAUSE LESS
THAN A TWO PERCENT RISE IN THE PRICE DEFLATOR IN 1976
ARE CONSIDERED BY MANY TO BE MOST OPTIMISTIC.

4. VILLAR MIR HAS BEEN PARTICULARLY CONCERNED BY GOS
BALANCE OF PAYMENTS AND FOREIGN DEBT PICTURE--FAR MORE
SO, INCIDENTALLY, THAN MANY OFFICIALS IN HIS MINISTRY
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OR AT THE BANK OF SPAIN--BUT WHETHER NEW EXCHANGE RATE
WILL SUBSTANTIALLY IMPROVE CURRENT DEFICIT WHICH
WAS ABOUT $3 BILLION IN BOTH 1974 AND 1975 IS SUBJECT OF
SOME DEBATE. OFFICIALLY, A REDUCTION IN THE DEFICIT OF 60 MILLION
TO $1BILLION WAS ESTIMATED AT TIME OF
DEVALUATION. SPANISH IMPORT DEMAND IS GENRALLY CONSIDERED
TO BE INELASTIC AND UNLESS GOS IS PREPARED TO SLOW
ECONOMIC GROWTH BELOW EVEN THE PRESENT LEVEL OF NO MORE
THAN ONE PERCENT WHICH PROBABLY IT IS NOT HIGHER
IMPORT PRICES WILL HAVE LITTLE EFFECT ON IMPORT LEVELS.

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LOWER EXPORT PRICES WILL UNDOUBTEDLY HELP SOME, BUT NO
ONE IS CERTAIN HOW MUCH. SPANISH EXPORTS DID SURPRISINGLY
WELL IN 1975, BUT FURTHER EXPANSION IS PROBABLY
MORE DEPENDENT ON CONTINUED ECONOMIC RECOVERY ABORAD
THAN ON A SLIGHT IMPROVEMENT IN COMPETITIVE POSITION.
DEVALUATION SHOULD HELP TOURISM SOME, BUT, AS WITH
EXPORTS, 1975 PERFORMANCE WAS GOOD AND THERE IS SOME
QUESTION AS TO HOW MUCH MORE REVENUE CAN BE SQUEEZED
OUT OF THIS SECTOR UNDER PRESENT WORLD ECONOMIC CONDITIONS.

5. CRITICS OF VILLAR MIR AND THE GOVERNMENT HAVE PERHAPS
UNFAIRLY EMPHASIZED THE ABSENCE OF ANY MEASURES ACCOMPANYING
THE DEVALUATION. IT IS WELL KNOW THAT THE MINISTRY OF FINANCE
HAS HAD A MAJOR NEW ECOMOMIC PROGRAM IN THE WORKD FOR
SOME TIME. THE DEVALUATION WAS TAKEN BEFOREHAND IN PART
TO STEM INCREASED SPECULATION AGAINST THE PESETA FOLLOW
ING DECLINE OF THE LIRA AND PARTLY BECAUSE VERY FEW PEOPLE
EXPECTED IT AT THAT TIME. TO GIVE THE GOVERMENT ITS
DUE, THE DEVALUATION WILL HAVE TO BE SEEN IN THE CON-
TEXT OF WHOLE PROGRAM ABOUT TO BE ANNOUNCED. BUT
WHAT REMAINS TRUE IS THAT NO ECONOMIC MEASURES, NO
MATTER HOW INTELLIGENTLY DESINGED CAN ENTIRELY REMEDY
THE MAJOR PROBLEMS FACING SPAIN IN THE FORM OF INFLATION,
BALANCE OF PAYMENTS DEFICITS, AND UNEMPLOYMENT.
THE KIND OF BELT TIGHTENING NECESSARY TO SOLVE THE PAY-
MENTS PROBLEM AND REDUCE INFLACTION WOULD BE AT BEST
MOST DIFFICULT AND MORE PROBABLY CLOSE TO IMPOSSIBLE
GIVEN THE PRESENT PLITICAL SITUATION, THE NEED TO LIMIT
UNEMPLOYMENT, AND THE GROWING POWER AND DEMANDS OF LABOR.
BUT AS ONE ECONOMIST HERE POINTED OUT, THE
DEVALUATIONCOULD HELP FORCE SPAIN TO TAKE SOME MUCH
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NEEDED LABOR AND FISCAL REFORMS, AND IF IT DOES IT WILL
THEN HAVE SERVED ITS PURPOSE.
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